Wholesale Markets

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Analysis of wholesale markets

January 2022

Short Term: Volatile

Geopolitical issues are placing a large degree of short term uncertainty in the markets, which is why prices are expected to remain volatile short term.

Long Term: Slightly Bearish

Current valuations are well above the historical range, which is why, over the long term, we expect prices to move back down towards this range, albeit likely at a gradual pace.

Downward price driver ↓

Upward price driver ↑

Bitesize Snapshot

- Threat of sanctions on Nord Stream 2 pipeline ↑
- European gas storage levels below 50% ↑
- Last winter month to navigate still ↑
- Reduction in Russian gas flows to Europe ↑
- French nuclear outages ↑
- Oil hits 10-year high in value ↑
- Plan B restrictions removed in UK ↑

- UK gas storage levels higher at 67% ↓
- Record-breaking LNG deliveries in January ↓
- Strong wind forecasts for February ↓
- OPEC+ easing production cuts ↓
- IFA interconnector due back to full operation in March ↓

Gas 36% ↑

Power 21% ↑

Price change from other commodities

Commodity	Value 03/01	Value 31/01	Value change
Brent Oil	$77.78	$91.21	+ 17.2%
UK ETS Carbon DEC 22	£77.19	£84.72	+ 9.75%
Coal 2021	$87.64	$116	+32.36%
Pound/Euro Cross rate	£1.19	£1.20	+ 0.8%

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Monthly Review and outlook of the wholesale markets for Gas and Power

January 2022

Review of market movements over January

After starting the month of January at the bottom of the festive dip, prices since rebounded, and consolidated towards the end of the month, resulting in a 36% rise for gas and a 21% rise in power prices. There have been a few main key events driving prices over the month:

Key Drivers

Geopolitical tensions over Ukraine and threat of Russian invasion.

All month, there has been continuous speculation that Russia is posed to invade Ukraine, with troops amassed at the borders. The markets have continued to price in this possible threat as tensions continued to grow. Russia has, however, always maintained it it not intending to invade, despite the military presence.

It is not so much an invasion itself that the markets are fearful of, but the repercussions that could follow. The EU and U.S. have repeatedly stated sanctions would be applied against Russia, and one of the more likely would be regarding Nord Stream 2 and restricting or banning its use. This would create uncertainty over long term gas supply into Europe.

The other threat is how Russia could retaliate to sanctions or even if its NATO demands are not met. Natural gas could be used as a 'political weapon' and we have already seen gas flows through the Mallnow pipeline flowing in reverse, away from central Europe for a number of weeks now.

This topic has been a key driver all month and, with nothing settled, the uncertainty will continue into February, with a number of possible outcomes.

Record-breaking LNG arrivals into UK

Though prices did see large gains in January, one big factor keeping prices in check, is the glut of LNG cargo deliveries into the UK and Europe. In total, 34 deliveries were seen in the UK.

With EU and UK spot prices trading above Asian markets for a few months now due to the European energy crunch, an increasing amount of LNG has been redirected towards us, as opposed to other international hubs. Where Russia has to an extent created a premium market, others are moving in to capitalise.

The markets are now trying to gauge if this level of deliveries can continue. If it can, it helps to reduce supply concerns. However in recent days, Asian spot prices have closed the gap on the premium European prices. If it was to exceed it once more like most of 2021, more LNG cargoes could start sailing Asian-bound once more.

A return to colder weather

The start and end of January were very mild, with temperatures well above average but, between these periods, we saw a sustained spell with temperatures at or below the seasonal averages. This lifted demand and, coupled with supply constrains and some outages, encouraged prices to move higher.

Oil hits 10-year highs

All wider energy commodities saw strong gains in January, but oil has drawn most of the spotlight, with a barrel of Brent now over $90 for the first time in a decade. Conflicts and tensions in the Middle East, along with the developing situation in Ukraine have speculated oil prices higher. A more fundamental driver is the fact there are signs some OPEC+ nations are struggling to reach their production quotas, due to supply constraints. This places doubt as to just how much OPEC+ is holding back in reserve from the production cuts and if they will be able to meet future demand.

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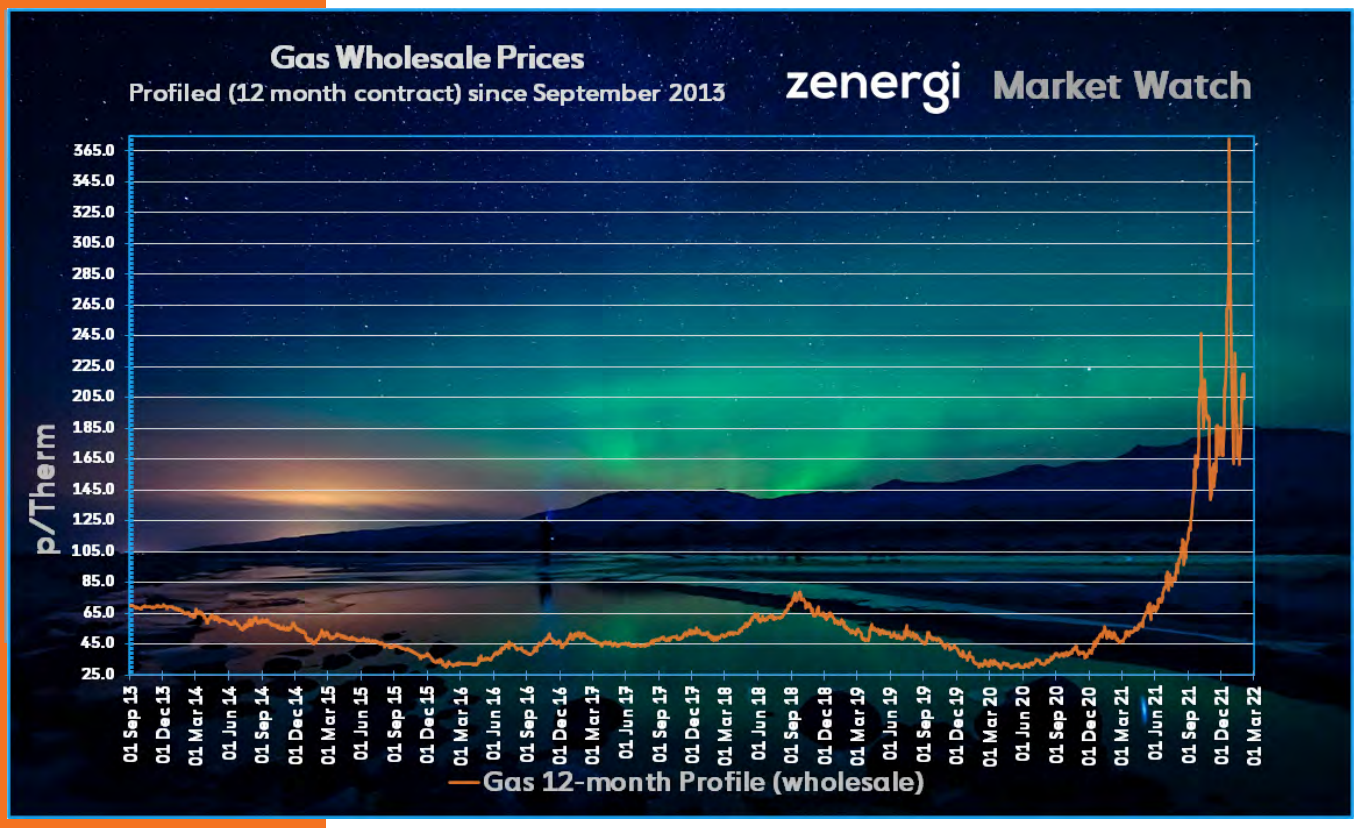
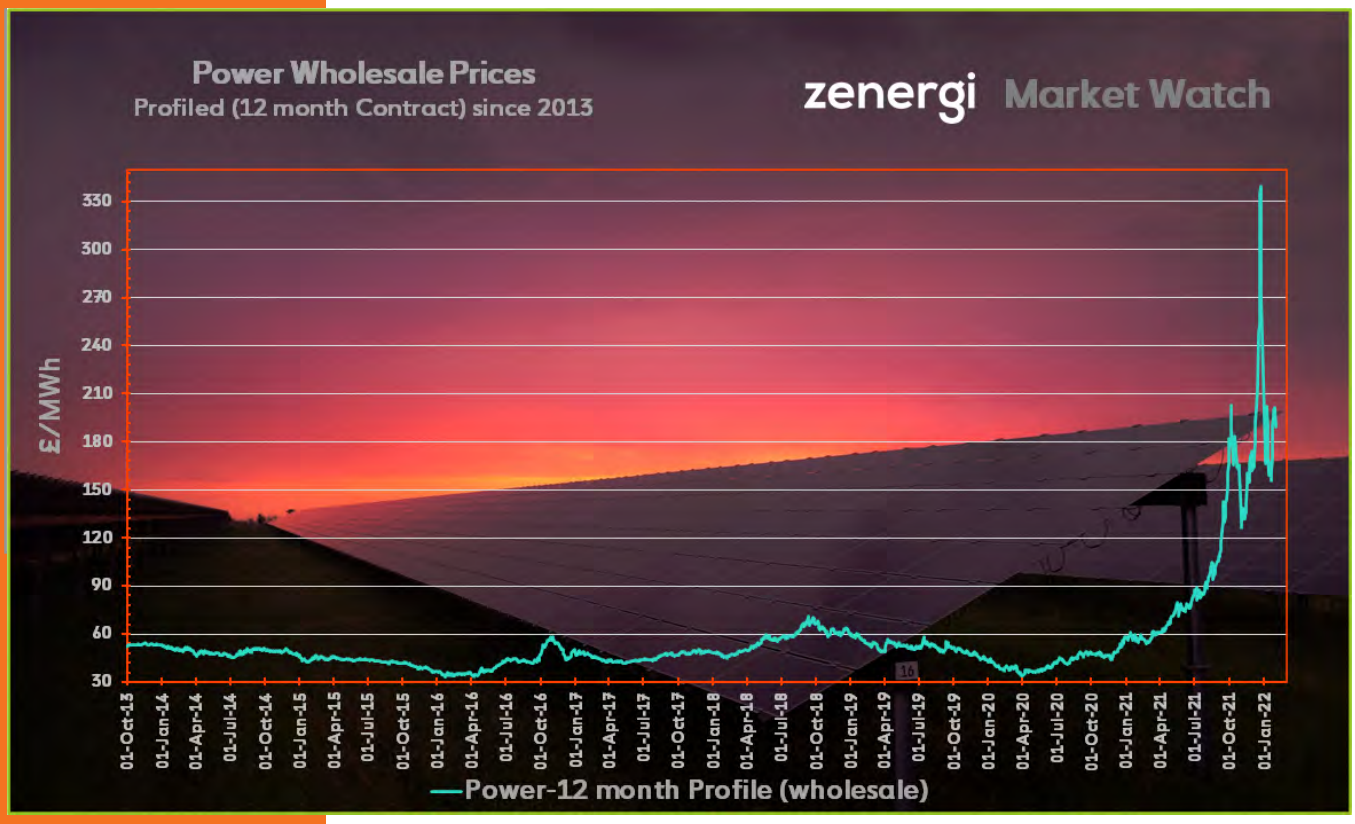
Long term Graphs

Graph 1: Wholesale gas prices 2013 to date



Graph 2: Wholesale power prices 2013 to date



Outlook

Prediction and key events for the month ahead

Developments between Russia and the EU/U.S.over Ukraine

Like last month, the 'Ukraine crisis' and possibility of conflict is set to continue into February. Much of the risk associated with an invasion is already priced into the markets however, there is likely to be room for it to go much higher if it was to occur. Similarly, if tensions can ease, we will quickly see the risk premium already priced into the markets fall off.

So we would expect the markets to swing dramatically either way on either outcome, but there is also the possibility this uncertainty rolls into March as well.

Will Oil and Carbon keep on moving higher?

Both oil and carbon have been on very long bull runs since the end of 2020, and have more or less continued to run higher in price, with the occasional breather. While these markets are not always key in seeing gas and power prices rise or fall, they have a lot of influence and it becomes harder to see prices fall if these two markets continue to rise.

Both are very different markets, affected by different variables. The bull case for oil continuing to rise, includes the possible Ukraine conflict, OPEC struggling to meet it current quota, demand rising as restrictions lift and summer driving season approaching. The bear case is that it is not often oil trades above $90 historically, and it is currently well above its mean average.

Carbon's momentum is perhaps even stronger long term as higher prices are seen as key to encourage carbon neutrality goals for companies and nations, with almost the entire world pledging to reduce emissions. Prices could come down at times if consumption of coal can be reduced, reducing the demand for the permits. Coal power generation has ramped up globally due to soaring gas prices, but if gas prices do come down, we will quickly see coal return to being phased out, and carbon permit prices could cool off.

Weather outlook for February

There is forecast to be a strong north/south split in February, with the north of the UK seeing seasonal average temperatures, more rain and stronger winds, while a high pressure system over the south will keep things more settled, milder and drier.

Brief cold incursions are still possible, and even brief cold snaps, but overall it is looking to be a month of above average temperatures and strong winds, which will both reduce demand and boost renewable generation. This could encourage wholesale costs down if the forecasts pan out as expected.

Recommendation

Right now, with the drivers in place, we could easily see the markets either move up 30% or drop 30% by the end of February, depending on how things develop. While January was another volatile month, prices do appear to be range-bound and consolidating. This is illustrated well in the daily 6-month timeline graph, but also illustrated in the above graphs. One strategy you could therefore undertake is to try and catch the market towards the bottom of its current range and resistance point. As of 2 February we appear to be moving towards the bottom of that range and a good opportunity could present itself soon.

There is every chance we will see prices fall further and break that resistance level but, as mentioned in the opening line, there is an equal chance we see another sudden rise in the markets if key events unfold. It is therefore a question of if you wish to ride the markets again or to secure it at the current levels.

The report is based on our educated opinion taken from publicly available data. This is not a guarantee on future price movements, market prices can go up or down unexpectedly